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No. 97-271

Supreme Court, U.S.
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In The

Supreme Court of the United States

October Term, 1996

In re

JAMES DELBERT McCONVILLE, and CLARA MAE McCONVILLE DBA McCONVILLE ENTERPRISES,

Debtors,

TEVIS T. THOMPSON, JR., TRUSTEE IN BANKRUPTCY FOR JAMES DELBERT McCONVILLE AND CLARA MAE McCONVILLE,

Petitioner,

v.

DAVID MARGEN AND LAWTON ASSOCIATES,

Respondents.

On Petition For Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

REPLY BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

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REPLY BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

Petitioner Tevis Thompson, Chapter 7 Trustee, respectfully submits the following reply in support of his Petition for Writ of Certiorari.

I. The Ninth Circuit Granted Equitable Relief Under Section 364 Of The Bankruptcy Code Only After It Wrongly Held That Bankruptcy Code Section 549 Was Inapplicable.

Respondents mistakenly seek to paint the Ninth Circuit's holding as a "fact-intensive application" of section 364 of the Bankruptcy Code which is not worthy of this Court's review. They address the Ninth Court's analysis of section 549 claim only secondarily, in almost dismissive terms. Respondents' argument ignores the fact that the Ninth Circuit addressed section 364 only after it summarily, and improperly, held that the post-petition transfer and recordation of Respondents' deed of trust was not a transfer under section 549 of the Bankruptcy Code. Regardless of whether the Ninth Circuit disposed of section 549 in either "a single string citation" or through an exhaustive analysis, its holding contradicts the clear definition of transfer in Bankruptcy Code section 101(54) and the holdings in *In re Photo Promotion Associates, Inc.*, 881 F.2d 6 (2nd Cir. 1989) and *In re Pointer*, 952 F.2d 82 (5th Cir. 1992).

Moreover, Respondents' attempt to distinguish *In re Pointer* fails. Section 101(54) of the Bankruptcy Code does not distinguish between voluntary liens (such as deeds of

trust) and involuntary tax liens. The post-petition creation and recordation of both such liens thus violate section 549. Respondents also misstate the Second Circuit's holding in *In re Photo Promotion Associates, Inc.* In that case, the Chapter 7 trustee brought a section 549(a) adversary proceeding to avoid an unauthorized post-petition assignment of debtor's receivables. The bankruptcy court found in the trustee's favor and avoided the lien under section 549(a). The bankruptcy court also found that the creditor had provided the bankruptcy estate with post-petition services and held that the creditor was entitled to a Chapter 11 administrative claim.

The Second Circuit affirmed the lower court's holding that the transfer of the security interest in debtor's account receivables violated section 549(a), and held that the creditor's administrative claim was junior to the Chapter 7 creditors with superior claims. The Second Circuit did not award an "equitable lien" to the creditor, nor could it. Section 549(c) was the only means by which the Photo Promotion creditor could have prevented the trustee from avoiding its lien under section 549(a). Having held section 549(c) to be inapplicable – and that the creditor could not preserve its lien – it would have been incongruous for the Second Circuit to provide the creditor with an "equitable lien" such as the one fashioned by the Ninth Circuit herein.

While Respondents devote much of their opposition to the propriety of the Ninth Circuit's balancing test and the equitable remedy that it fashioned under section 364,

no such equitable lien is available under section 549.[1] Rather, section 549(c) provides the only means for Respondents to preserve their lien. As discussed below, Respondents cannot satisfy the requirements of section 549(c).

II. Respondents Are Not Protected By Section 549(c).

Respondents were not **purchasers** of **real property** and thus cannot find sanctuary in section 549(c). Section 549(c) states in pertinent part that "The trustee may not avoid under subsection (a) . . . a transfer of real property to a good faith purchaser. . . . " Section 549(c) is meant "to protect against a fraudulent debtor **selling** real property, or its interest therein, to an innocent **purchaser** who has no knowledge, or reasonable means of knowledge, of the pendency of the bankruptcy case." (Emphasis added). *Collier on Bankruptcy*, 15th Ed. Section 549.03, pg. 549-12. Section 549(c) therefore offers a very narrow exception for unauthorized, post-petition transfers. *In re Schwartz*, 954 F.2d 569, 574 (9th Cir. 1992). To satisfy § 549(c), Respondents must demonstrate that their deed of trust

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[1] Not surprising, all of the cases cited by Respondents in which an "equitable lien" was approved involved a nunc pro tunc application of section 364(c). Respondents have not, and cannot, cite to any cases in which a court approved an equitable lien under section 549. In addition, Respondents never requested that the bankruptcy court approve its deed of trust nunc pro tunc under section 364(c). The "Federal Improvement Lien" to which Respondents refer is authorized by section 550(e), which permits certain section 549(c) defendants to obtain a lien for the cost of any post-petition improvements which they made to the property recovered by the trustee.

constituted a transfer of **real property** for which they were good faith **purchasers**. Respondents cannot satisfy either element. Under California law, a deed of trust is personal, not real property, and Respondents are not "purchasers" under applicable bankruptcy law.

Section 101(43) of the Bankruptcy Code defines the term "purchaser" as a "transferee of a voluntary transfer. . . . " While the Bankruptcy Code does not define the term "transferee," the Courts of Appeal consistently apply a "dominion or control test" to determine whether a person is a transferee. See *Bonded Financial Services v. European Am. Bank*, 888 F.2d 890 (7th Cir. 1988); *In re Bullion Reserve of North America*, 922 F.2d 544, 548-549 (9th Cir. 1991): "Although the Bankruptcy Code does not define 'transferee', and there is no legislative history on the point, *we think the minimum requirement of status as a 'transferee' is dominion over the money or other asset, the right to put the money to one's own purposes.*" [Quoting from Judge Esterbrook's opinion in *Bonded Financial Services v. European Am. Bank*, 838 F.2d 890, 893 (7th Cir. 1988)] 922 F.2d at 548 (emphasis in 9th Circuit's quotation).

Respondents are not "purchasers" under § 549(c) because they were not "transferees" of the real property. Respondents, as lienholders, did not own, control or manage the real property. It was debtors who had absolute control over the real property. Respondent only had dominion and control over their note and deed of trust, but not the real property itself.

In addition, Respondents' deed of trust is not real property under California law. Respondents received two instruments from debtors: a promissory note and a deed

of trust. Under California law, both of these items are personal property. California Civil Code § 658 defines "real property" as follows: "Real or immovable property consists of: 1. Land; 2. That which is affixed to land; 3. That which is incidental or appurtenant to land; 4. That which is immovable by law. . . . " California Civil Code § 663, in turn, provides that "Every kind of property that is not real is personal."

A deed of trust therefore is personal, and not real property. Indeed, California Civil Code § 2888 states that "notwithstanding an agreement to the contrary, a lien, or a contract for a lien, transfers no title to the property subject to the lien." None of the case law cited by Respondents interprets California Civil Code sections 658, 663 or 2888, or holds that a transfer of a California deed of trust constitutes a purchase of real property under § 549(c).

III. The Creation And Recordation Of Respondents' Deed Of Trust Constituted A Transfer Of Property Of Debtor's Bankruptcy Estate.

Respondents argue that since the bankruptcy estate's interest in the real property purportedly did not exist before their lien was created, there was, under *Farrey v. Sanderfoot*, no transfer of estate property. Respondents' argument falls short on all levels. First, the *Farrey* Court interpreted section 522(f)(1) of the Bankruptcy Code, which authorizes a debtor to avoid the *fixing* of a lien on the *debtor's* interest in property. This Court analyzed section 522(f)(1)'s specific language and held that a debtor could avoid the fixing of a lien only if he owned the property before the lien attached to it.

> "No one asserts that the two verbs [annul and fix] underlying the provision possess anything other than their standard legal meaning: 'avoid' meaning 'annul' or 'undo' . . . and 'fix' meaning to 'fasten a liability upon'. . . . The statute does not say that the debtor may undo a lien on an interest in property. Rather, the statute expressly states that the debtor may avoid 'the fixing' of a lien on the debtor's interest in property. The gerund 'fixing' refers to a temporal event. That event – the fastening of a liability – presupposes an object onto which the liability can fasten. The statute defines this pre-existing object as an 'interest of the debtor in property.' Therefore, unless the debtor had the property interest to which the lien attached at some point before the lien attached to that interest, he or she cannot avoid the fixing of the lien under the terms of § 522(f)(1)." 111 S.Ct. at 1829.

Since *Farrey* was decided, no court has applied its analysis to any of the other avoidance sections of the Bankruptcy Code (i.e., §§ 544, 545, 547, 548, 549, 552), or to § 362. *Farrey's* limited application is not surprising. Section 549(a) has no such temporal limitation. Rather, section 549(a) simply and plainly authorizes a trustee to avoid a transfer of property of the estate made after the commencement of the bankruptcy case. Indeed, the *Farrey* Court made clear that its holding is simply its interpretation of section 522(f)(1)'s exact language. The *Farrey* Court held that section 522(f)(1)

> " . . . cannot be concerned with liens that fixed on an interest before the debtor acquired that interest. Neither party contends otherwise. Section 522(f)(1) does not state that any fixing of a

> lien may be avoided; instead, it permits avoidance of the 'fixing of a lien on an interest of the debtor.' If the fixing took place before the debtor acquired that interest, the 'fixing' by definition was not on the debtor's interest." 111 S.Ct. at 1830.

Respondents also cannot seriously contend that the transfer of the lien was not a transfer of estate property. Property of the bankruptcy estate is wholly distinct from a debtor's interest in property. The phrase "property of the bankruptcy estate" is defined in Bankruptcy Code section 541(a)(1) to include all legal or equitable interests of the debtor in property as of the commencement of the case. The definition is further expanded in section 541(a)(6) to include "products, product, offspring, rents or profits of or from property of the estate . . . and (7) to include 'any interest in property that the estate acquires after the commencement of the case.' " (Emphasis added). The question of what is property for purposes of § 541(a)(1) is a question of federal law. *Board of Trade v. Johnson*, 264 U.S. 1 at 10, 44 S.Ct. 232 at 234, 66 L.Ed. 533 at 536 (1924) (interpreting § 70(a) of the Bankruptcy Act, the predecessor to § 541).

When the debtors filed their Chapter 11 case, they had entered into a binding and enforceable pre-petition contract for the purchase of the real property. (See Appellants' Excerpts of Record 84, Findings 2, 3 and 4). Section 541(a)(1) includes a debtor's pre-petition contract rights. See *In re Computer Communications, Inc.*, 824 F.2d 725 (9th Cir. 1987), *In re Ryerson*, 739 F.2d 1423 (9th Cir. 1984). As a buyer under an executory contract to purchase real property, the debtors had rights in the property. For example,

they had the right to seek specific performance of the contract (see California Civil Code sections 3384 and 3387) and record a notice of lis pendens. California Code of Civil Procedure sections 405.4, 405.20.

When the debtors acquired title to the real property, the entire property became "property of the estate" pursuant to § 541(a)(6)[2] and § 541(a)(7). There can be little doubt, therefore, that the real property was property of the estate both before the actual acquisition of title and, of course, when title was acquired.

Moreover, even if – as Respondents contend – Respondents' lien and transfer of title arose simultaneously, the lien still constituted a transfer of property of the bankruptcy estate. Under California Civil Code section 2883, a lien attaches only when the person granting the lien obtains an interest in the liened property. Simply put, the transfer of the lien to Respondents was dependent upon debtor's ownership of the real property.

Since the concepts of "property of the estate" and "interest of the debtor in property" are so fundamentally different, the *Farrey* Court's analysis is completely

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[2] The fee title to the property is a product or offspring from the contract right owned at the date of filing. See *Bradt v. Woodlawn Auto Workers F.C.U.*, 757 F.2d 512, 515 (2nd Cir. 1985) (Insurance payment for repairs to automobile which was property of the estate was also property of the estate, because definition of "proceeds" in § 541(a)(6) is broader than that term in Uniform Commercial Code. Conversion of form of property of the estate does not change its character as property of the estate).

inapplicable to section 549's prohibition against the post-petition transfer of "property of the estate."

CONCLUSION

The Ninth Circuit's decision creates a clear conflict within the Circuit Courts of Appeal, and the Petition for Certiorari should be granted.

Dated: October 3, 1997

Respectfully submitted,

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